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New Twist

Insurers are legally and morally obliged to inform policy owners about the availability of life settlements

By David M. Lewis

We in the life settlements industry believe the single most significant impediment to the growth of the life settlement market is policy owners' lack of awareness. Every day people surrender or lapse their policies without knowing that they might have qualified for a life settlement that would have provided more than the cash-surrender value.

As no lapse or surrender happens without the insurer being aware of the act and the age of the insured, life insurers are in a position to advise policy owners of the existence of the life settlement market. Furthermore, the life settlements industry believes that insurers have a legal and moral obligation to inform their policyholders of the availability of life settlements. If they fail to do so, insurers eventually can be drawn into class action litigation by disgruntled former policy owners.

The insurers traditionally have taken the position that they have no legal obligation to make such disclosures, and have resisted any effort to adopt express legislation or rules requiring them to do so.¹ Nevertheless, the National Association of Insurance Commissioners (NAIC) has begun to seriously address suitability issues regarding seniors, and has adopted a model suitability rule to govern seniors' annuity transactions.

OUR CASE

What legal requirements do we in the industry believe compel insurers to inform policy owners who are age 65 or older about the availability of life settlements?

State insurance laws prohibit practices known as "churning" or "twisting." These practices generally relate to improperly convincing an insured to cancel one policy and buy another based upon misrepresentations by the insurer or its agent. So if a 70-year-old policyholder asks his insurer, "If I no longer want this policy, is

there anything else I can do with it other than surrender it or let it lapse?" and he is told, "No, there are no alternatives," that would be a misrepresentation or misleading statement.⁵

What happens when the policyholder does not question his insurance agent, but the insurer has sent him lapse notices and other information regarding his options under the policy? Are those notices now "misleading" if the insurer knows that a life settlement might be an option for the policyholder? What if the insurer has consciously adopted a policy of not providing information regarding life settlements to insureds, or advising insureds to lapse their policies rather than receive life settlements? What if the insurer has prohibited its agents from engaging in life settlements? If the statements from the insurer can be characterized as "misleading," they are actionable.

If the insurer has the intent of limiting its exposure to life settlements, then statements that might be innocuous in some other context become a pawn in carrying out the insurer's intent to limit the life settlement market. Caution would dictate that insurers take steps to inform policyholders about the potential availability of life settlements.

There are at least two other legal theories that may intersect with the anti-twisting provisions that merit some discussion. There is a long line of case law finding that an insurer may not lapse a policy if it holds funds due the policyholder that are sufficient to pay the premiums. Conceptually, if the insurer remains mute while knowing there are readily available parties who would keep the policy in place and pay the policyholder for it, is that not analogous to the situation in which the insurer fails to act to prevent a lapse while holding funds due the policyholder?

In *Wilner v. Sunset Life Ins. Co.*,⁷ a California appellate court in 2000 held that a claim in a twisting case also entailed a cause of action under California's unfair competition laws. The court ruled that a practice could be actionable even if not unlawful—if it is unfair or deceptive. The court stated that the harm to the victim should be balanced against the utility of the defendant's conduct. The court said, "A business practice is unfair when it 'offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.'"⁸

The appellate court's message could not be clearer: Practices that take advantage of unsuspecting consumers and cause them injury are

State laws against "twisting" or "churning" may snare insurers who fail to mention life settlements.

exposed to actionable claims for unfair competition. If you cashed in your life policy and no one told you that you had an option to get three or four times the cash surrender value, how would you feel?

Insurers who fail to make reasonable efforts to inform policyholders about the existence of the life settlement secondary market run a substantial risk of exposure to legal claims and damages from people who surrender or lapse their policies without being given this information. This risk increases when the insurer also takes conscious steps to limit its exposure to the life settlement market because such actions, coupled with its failure to disclose, take on the character of an unfair trade practice.

Some insurers and broker-dealers continue to forbid their registered agents from involvement in the viatical and life settlement marketplace. These prohibitions involve separate legal issues. But, to the extent that such prohibitions lead to inadequate and/or inaccurate disclosures by insurance agents, the legal principles already outlined here are implicated. When the insurer tells agents to stay away from the life settlement market, is an agent who fails to advise his client about the possibility of a life settlement going to be penalized or sanctioned by the insurance company? One would suspect not.

Many substantial life policies eligible for life settlements are held in trust. Commentators consistently have suggested that the trustees of insurance trusts should periodically review the trust assets to determine the continued viability of holding the assets in the trust. This type of review is normally conducted with the advice and assistance of the insurance agent. If the agent believes that he should not tell the trustee about life settlements because of a directive from the insurer, the trustee's decision-making process is skewed, and the advice from the agent is tainted—at best. If an agent feels he cannot give advice regarding life settlements, he should say so, recommending the trustee seek input from another qualified source.

Insurers have legitimate concerns about the viatical and life settlement market. There is no doubt that insurers have been defrauded by people obtaining policies through false statements, and that private investors have been fleeced by fraudulent viatical investments. At the same time, though, life settlements are a useful tool in appropriate circumstances, and the life settlement market has been relatively free of complaints from people who've sold their policies.

Meanwhile, we in the life settlement industry need to step up our efforts to educate insurers regarding our product and to demonstrate that life settlements operate in the best interests of the insurance marketplace. ■

Endnotes

1. Letters from Viatical and Life Settlement Association of America (March 4, 2002, March 15, 2002, May 28, 2002, and July 20, 2002) and Life Settlement Institute (July 30, 2002) to Carolyn J. Johnson, staff attorney to NAIC Viatical Settlements Working Group.
2. Paul F. Kirsch, "Will History Repeat Itself?" *California Broker*, p. 61 (March 2003).
3. Letter from Victoria Fimea, American Council of Life Insurers, to Carolyn J. Johnson, NAIC (Feb. 24, 2003).
4. National Association of Insurance Commissioners' Senior Protection in Annuity Transactions Model Regulations (adopted Sept. 14, 2003).
5. Such a false statement would likely constitute common law fraud as well.
6. See 8 A.L.R. 3rd 862, and the cases cited therein.
7. 78 Cal. App 4th 952 (2000).
8. 78 Cal. App 4th at 965, citations omitted.
9. The discussion in this article relates to insurance policies that are not securities. In the case of variable policies, well-established law under the Securities Exchange Act of 1934 would add further support for the obligation of the insurer to make complete disclosure to the policyholder.
10. Nothing contained in this article is intended to suggest that an agent or registered representative should engage in a life settlement transaction without proper disclosure to the insurer and/or broker-dealer, or without obtaining the proper consent of the insurer, as may be required by law or by NASD or stock exchange regulations. Life settlements that involve variable insurance policies are "securities" under federal law and payment of a commission to someone other than a registered broker-dealer is not permitted. The NASD and the stock exchanges have strict prohibitions on registered representatives engaging in outside transactions without the proper disclosure and consent, and pursue vigorous regulatory action against registered representatives who are accused of "selling away."

If an insurance agent feels he cannot give a trustee advice about life settlements, he should say so.